RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

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January 28, 1981 **LETTER 801**

Jan. 16, DJIA 973.29; PTI 1416; A-D Ratio –17.24
Jan. 23, DJIA 940.19; PTI 1395; A-D Ratio –18.23

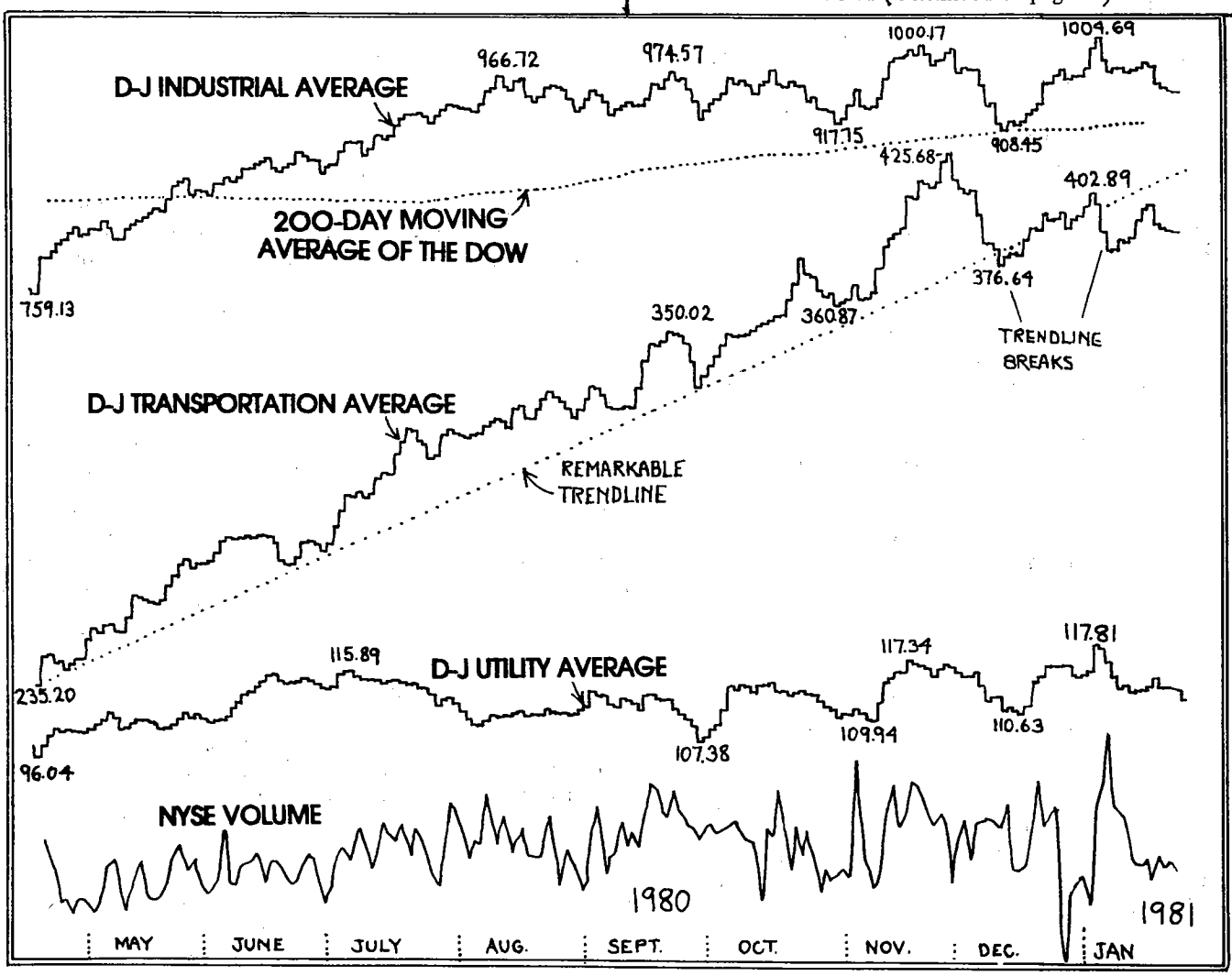
THE MARKET: In all my years of market writing and observation, I don't think I've ever seen such a SPLIT in intelligent professional opinion. Mind you, I didn't just say professional opinion, I said INTELLIGENT professional opinion, opinion I respect, opinion I've watched and studied in some cases for many years.

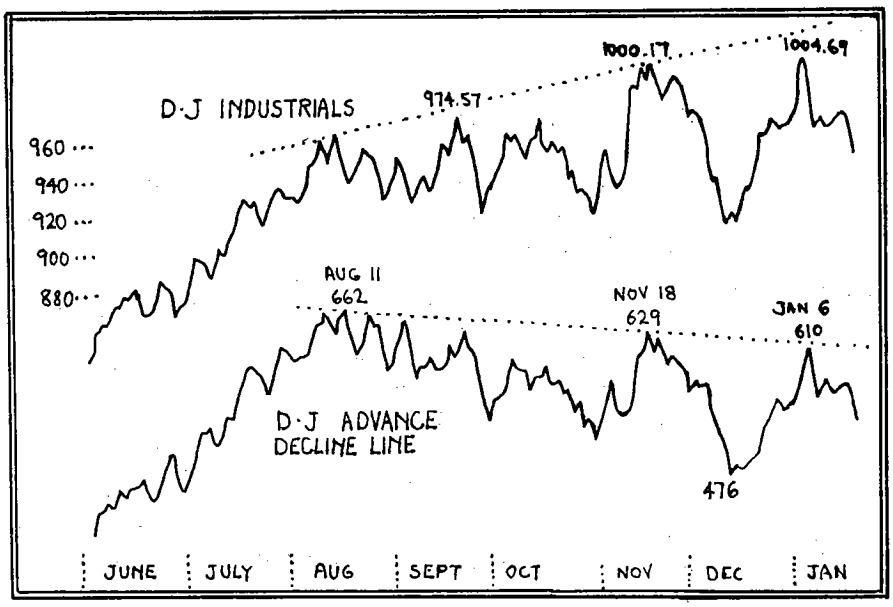
Joe Granville, in case you haven't heard, is bearish and short the market. The Trendway Service (Dysart) is bearish and believes we are in a top area. Trendex of Houston is cautious to bearish but believes this market may have one more rally in it. Perry Wysong (Consensus of Insiders) is bearish, but allows for another near-term rally.

On the other side, Ned Davis is bullish, and he notes that the ratio of odd lot sales to purchases on "Granville day" was the highest in history. Smart Money (Yale Hirsch) in a Special Bulletin (Jan. 15) says "Straight UP!" and he states, "Again we say the '80's belong to common stocks." Larry Williams writes that his Jan. 1 report is "the most important market report I.ve written in 14 years," and he states that we are not

FRONT PAGE COMMENT: Budget Director David Stockman has his hands full. Stockman is young (34) and he has no political constituency. But he's a firebrand, and he's laying it on the line when he says that the Reagan Administration must move FAST and decisively on major Government spending cuts or the whole Administration's economic plan will bog down. Personally, I believe that Stockman, Regan (Treasury) and Volcker (Fed) all know the story on the disastrous Federal spending. But it remains to be seen whether President Reagan is going to take the emergency actions which are needed, or whether he is going to be a measured, "calm," political compromiser. At this stage of the game, there is NO ROOM FOR COMPROMISE. If the Government does not move, the situation will soon move the Government.

A bit of background: third quarter Federal spending in the US in 1980 was 27% (no, that's not a misprint) *above* the year's earlier figure. The US budget is now totally out-of-control. The budget deficit for 1981 looks to be $80 to perhaps $100 billion. But that is only the cash deficit. If we look at total INDEBTEDNESS, the picture is far, far worse. In fact, it's a river turning into an ocean of red ink. (Continued on page 2.)





quite there yet but nearing a major buy signal. The Professional Tape Reader (Weinstein), while not bullish on the near term, is "very bullish" for the long term. Market Logic expects 1981 to be a primary bull year with "intermediate weakness" during the early part of the year. And so it goes.

As subscribers know, I have stronger opinions about investing at this point than I do about overall market direction. I believe that investors will best be served by high-yielding T-bills rather than equities at this time. The yield on stocks is now in the 3% to 5.5% area while the yield on T-bills is above 15%, a 10% advantage in favor of T-bills! This means that when you buy a stock here, you are most definitely playing for appreciation – yield alone will render you a loser. So with the trend of stocks a puzzler at this juncture, I have opted personally for T-bills.

In the last Letter I mentioned two important considerations for this market. The first is the Dow Theory. According to the Dow Theory, a trend is conceded to remain IN FORCE UNTIL PROVED OTHERWISE. The last confirmed trend was bullish. In order to reverse the bull trend, it will be necessary for the Averages to give a bearish indication. Such a bear "signal" would be a decline by the D-J Industrial Average (page 1 chart) below its December low of 908.45, confirmed by a Transport break below its own December low 376.45. That has not happened yet, so as far as Dow's Theory is concerned, the price structure remains bullish.

A second consideration (page 3 chart) is the pattern of the Primary Trend Index. But like the Dow Theory, the PTI has not yet given a bearish indication. Until it does, it would be best to hold a bullish to neutral opinion.

Technically, the weakest sector of this market is the breadth sector. (1) The A-D ratio for the NYSE has failed dramatically to confirm the rise in the D-J Industrials (see chart). (2) My positive volume index (which is the A-D differential on days when NYSE is rising) is looking toppy, and that makes me very uncomfortable. (3) The A-D line for the 30 Dow Industrial stocks has failed (see page 3 chart) since August 11 to confirm the successive new highs in the Dow Average; thus the Industrial Average itself is internally weak as evidenced by the three declining peaks in the Dow A-D line.

Question: Russell, you identify weakness in three important breadth indicators. Yet your PTI has not yet given a bearish indication. How do you account for this?

Answer: I can't – yet. But in view of the weakness in the various breadth indices, I do find it remarkable that the PTI still seems to be resisting the downturn. Study the PTI during the January-March, 1980 period. At that time it fell away along with the Dow and the market–no resistance to decline then. But today (at least up to now) the PTI has been exhibiting a mysterious stubborness–as if it does not want to collapse.

What does this portend? As I see it, the PTI seems to be telling us that market weakness so far is spotty, fragmented. There has been real resistance to the downside. Of course this could change very quickly, but I have to deal with what I see now, not what might be in a day or a week.

In the final analysis, it all boils down to whether the PTI can continue to hold above the rising trendline as shown on the chart. Or whether the PTI turns down *on a trend basis* and shatters the long ascending trendline that I have drawn from the July low.

I am now going to add a third consideration. This is based on my 233-day market cycle, a phenomenon which I have written a good deal about. I have found this cycle to be of great use in tracking the market, and the page 3 chart traces the path of the Dow and the 233-day cycle from 1976 to the present. The cycles are labeled A through H, and the high (H) and the low (L) of each completed cycle is shown. Each cycle consumes 233 days, 144 days on the upside and 89 days on the downside.

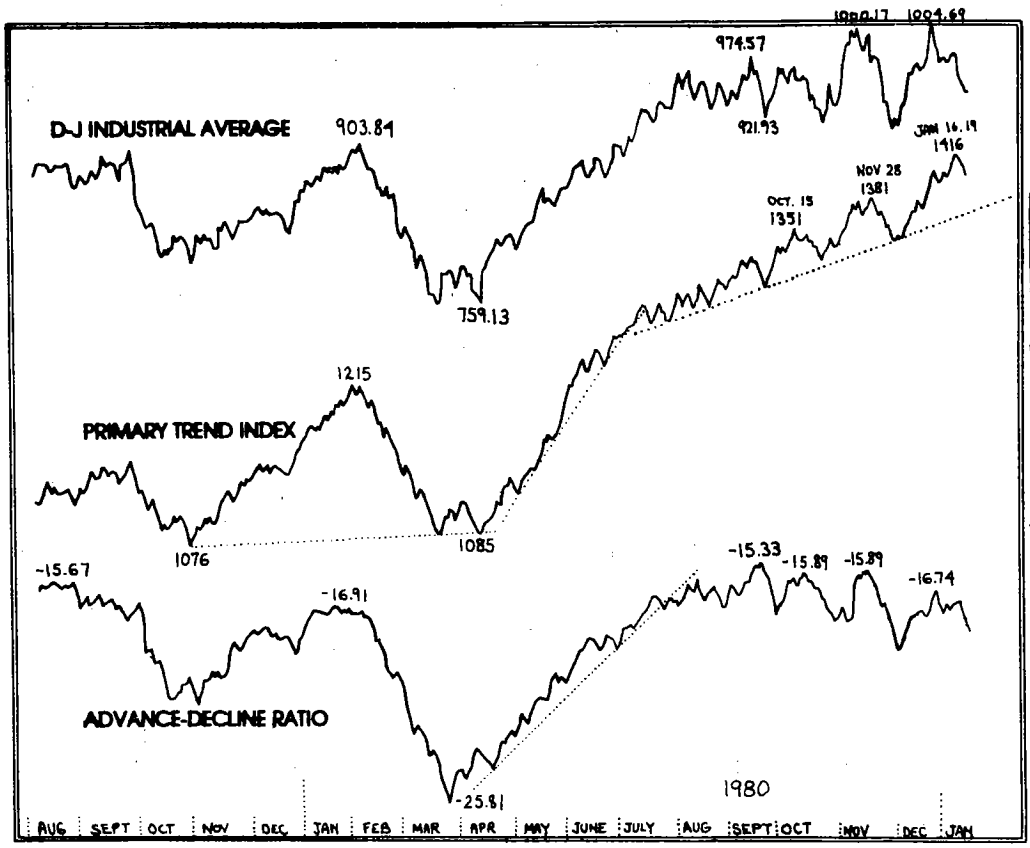
The last cycle peak occurred in August, 1980 (cycle G on the chart). From there the Dow pushed somewhat higher, faltered, fluctuated crazily, and finally plunged to the December 11 cycle low of 908.45. This means that we are now in the bull segment of the H cycle, and the bull segment should continue until early May.

At this point the cycle study is particularly interesting. Note that since 1976 or through six completed cycles (A through G) only one bull segment of the 233-day cycle failed to move the Dow higher. That exception was during cycle C.

Therefore the odds are good that when the bull peak of this cycle is reached, the Dow will be higher than when the cycle be-

The difference between the cash and the "balance sheet" concepts arise from the indebtedness brought on by Social Security, the Civil Service Retirement Fund and other "off budget" expenses. The unfunded liabilities of the Social Security system alone are now rising at a rate of about $250 billion a year. Thus it is clear that Social Security will either eat up the country or it will have to be *drastically* changed.

I'll say it once more. This nation is heading into one of the most unbelievable financial binds that ever hit a major power during modern times. Overspending and unfunded liabilities are close to tearing the economy apart. And this is the reason why all those who expect interest rates to "come down" are due to be disappointed. A great revolution is about to hit the US. It will be a revolution of lowered expectations and declining standards of living. It's only a question of who takes the brunt of the decimation, the people or the bureaucracy.



those lows. A further confirming Average is the Utility Average. It's ability to hold above the December low of 110.63will be significant.

INVESTMENT POSITION: No change: if you do have some stocks or mutual funds, sit tight until we get either a bear signal in the Averages or a definitive bear signal in the PTI. That hasn't happened yet. Personally, I continue to advise Treasury bills. These safest of all debt instruments are now yielding over 15% (for the 91-day bills). For convenience on smaller amounts ($1000 or over), use *Capital Preservation Fund* (Calif. 800-982-6150, other states 800-227-8380) which holds primarily T-bills. Their new number 2 fund (which deals in repos) now pays over 18%. As for gold, hold *limited* positions and forget about fluctuations. Gold is gold, and it's the ultimate safeguard against disaster. What disaster? Give us time, we'll come up with one.

gan (the cycle began for the Dow at 908.45). Yet another inference presents itself. With the bull segment of this cycle due to end in early May, we will watch the action of the Dow carefully. IF the Dow is weak enough to sink below 908.45 by early May (that would be a contra-cyclical performance), we will have a clear signal that something is drastically wrong on both Main Street and Wall Street.

Question: Could the fact that we are now in the bull segment of the 233-day cycle have something to do with the performance of the PTI?

Answer: Conceivably. The PTI might be tuned in or sensing the cyclical factors, and this could be exerting a positive influence on the PTI.

Question: Russell, again, what are you looking at in the Averages?

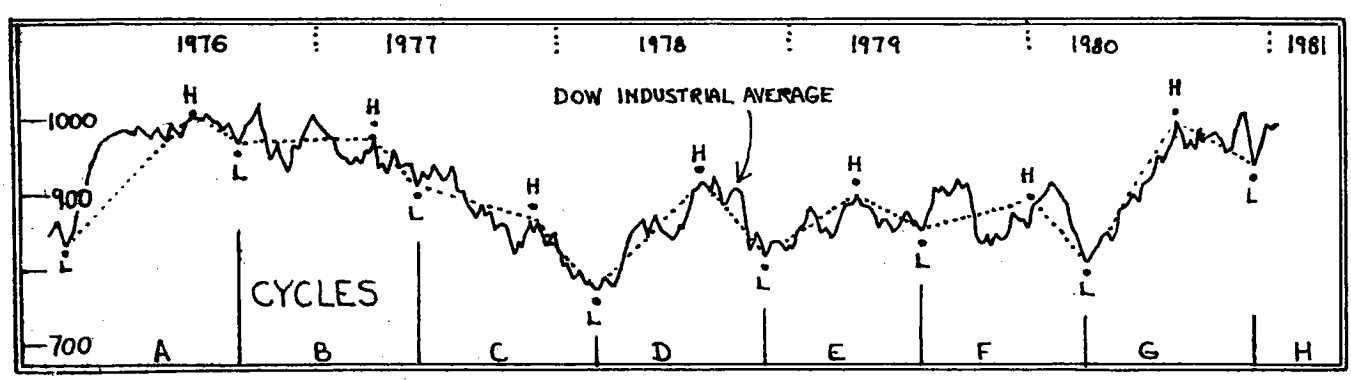
Answer: The same thing I was looking for when I wrote the last Letter. Despite all the nonsense being bandied about, the critical levels for the Averages are the December lows (i.e., the preceding reaction lows) of 908.45 for Industrials, 376.64 for Transports. As far as Dow's Theory is concerned, the bull case will remain intact as long as ONE OR BOTH of the Averages hold above

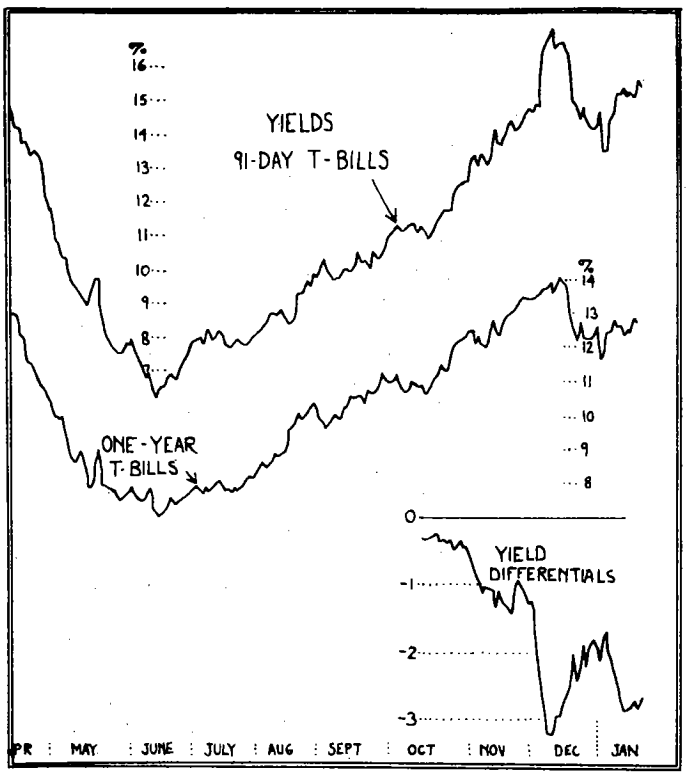
MONEY, MONEY: Normally, the longer one waits for his money, the greater the risk. Now in the money markets one gets paid for taking risk. Therefore, the "normal" rule is that the far-off yielding maturities yield more than the safer near-term maturities. For instance, in normal times a 10 year bond will yield substantially more than a 91-day T-bill; it's as simple as that.

Except, that these aren't normal times! What's happened is that pressure has come into the short-term market where most of the new money is to be found today. Because investors are shying away from long-term commitments, it's the near-term market that borrowers are now swarming to.

When short-term rates move above longer term rates, we get what is termed the inverse or "negative yield spread." A negative yield spread is a function of an abnormal market, a market that is under extreme pressure on the short end.

The page 4 chart shows where we are now in the money market. The top line on the chart is the daily graph of the yield on the 91-day T-bills. The next line is the daily yield on the one-year T-bill. The bottom line shows the differentials in yields between the 91-day and the one-year T-bill. Note that this differential (or negative yield spread) dropped to minus 3% in October. By Novem-





ber the negative spread sank to minus 2%. During December the negative yield spread tumbled to over minus 3%, and as of this writing, the negative spread continues near minus 3%.

The chart is telling me that there is a lot of pressure on the near-term money market, and that pressure started building up during October. As long as this negative yield pressure continues, I don't expect to see any real drop in short term yields. In the meantime, the 91-day T-bills continue to offer great safety and juicy yields to investors, and I've been recommending these bills in every Letter.

For the edification of new subscribers, the T-bills can be purchased directly from your nearest Federal Reserve branch, and there is no commission involved. But it is far more convenient to purchase the bills from your bank or broker (there is usually a $30 service charge). However, if you wish to sell a part of your commitment before the maturity date, it is extremely difficult if you purchased the bills from the Fed, while it is easy if you bought the bills from a bank or broker. The T-bills are a first obligation of the US Government, they carry the "full faith and credit" of the Government. The bill yields are also excluded from all state taxes (but not from Federal taxes).

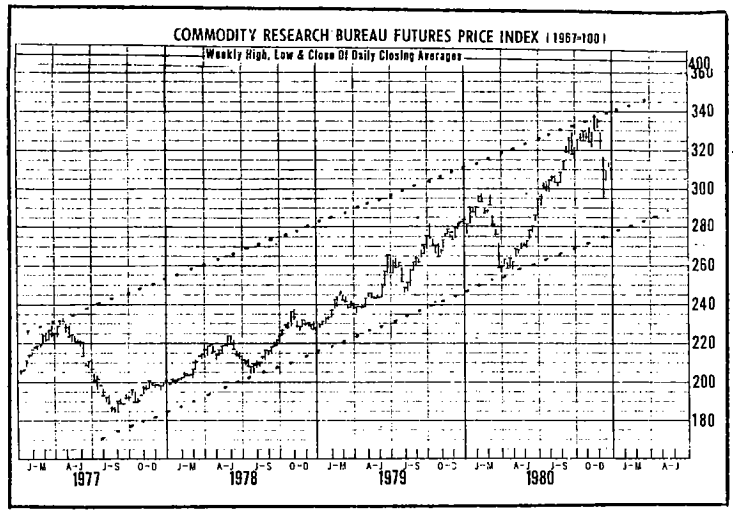
Two more ideas for high-income investors: The HUD issued *project notes* which are available from the municipal bond departments of major banks in multiples of $25,000. They can be purchased for 6-month maturities (sometimes less). PN's from your own state or from Puerto Rico are free from both state and federal taxes. Yields on PN's run about 7% at present.

The new tax-free money funds are useful and offer convenient checking facilities. IDS is one that I like. Average maturities at IDS on obligations they hold are around 70 days, and 85% of these maturities are AAA rated. Current yield on the *IDS Tax-Free Money Fund* is about 6.03% (figured daily) which is equivalent to 11% if you're in a 50% tax bracket, around 18% if you are in the 70% bracket. Call 800-IDS-IDEA for full information plus prospectus.

Item: during October 1 to December 12 the Treasury borrowed over $30 billion in NEW money. From December 12 to January 31 the Treasury borrowed $5 billion in new money. During February and March (coming up) the Treasury will be raising over $21 billion in new money. Thus, we should see added pressures on the money market very shortly.

Item: Dr. Henry Kaufman, the super-maven from Salomon Bros. predicts new highs in interest rates this year with a prime over 21½%. I've been expecting it all along; that's why I've been saying – "Stay with T-bills."

CHART OF THE WEEK: This chart is a very telling one, it's the widely watched CRB Commodities Futures Index. Despite the fact that the inflation rate is now declining on a year to year basis, the CRB Index has not yet reversed its rising trend. The CRB Index is one of the best gauges of inflation, and until this index breaks the lower trendline any forecasts regarding the end of inflation will be premature.



NOTES & QUOTES: Of this year's total Federal budget of $663 billion, $501 billion is made up of only five items. Biggest item is defense ($161 billion), next is Social Security ($138 billion), interest on national debt ($94 billion), Medicare and health ($66 billion), public assistance, food stamps ($42 billion). Defense is going up, interest on the debt is going up. This means that cuts can and must come in Social Security, Medicare, and public assistance.

Social Security is slated to rise to $159 billion next year up 15% from this year's $138 billion and up an unbelievable 36% from last year's $117 billion. The dreadful fact is that SS constitutes 21% of the entire Federal budget, and SS is literally eating up the nation alive. SS will have to be drastically changed or it will bankrupt itself and the US. Being unfunded, SS is now set up as a massive taxing and fund transfer program. Watch for dramatic changes (they absolutely MUST come) in the Social Security program!

* *

I am in favor of renouncing the Carter agreement on the hostages. Just as a forced confession will not stand up under law, I believe that an international agreement in the form of extortion should not stand up under law. I believe we owe the Iranians NOTHING. I would (1) renounce the agreement with Iran and hold up all further payments, (2) announce that the US will never pay another penny of ransom, (3) announce that any nation that takes US hostages is committing an act of war against the US.

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I have been saying for over a year that US finances are "out-of-control." Listed below are the Federal deficits since 1961, and a glance at this chart shows that the cork is out of the bottle. Reagan inherits the fruits of two decades of profligacy. His choice is clear, "Cut the budget or preside over a financial crisis of the first magnitude."

1961	$3,406,000,000
1962	$7,137,000,000
1963	$4,751,000,000
1964	$5,922,000,000
1965	$1,596,000,000
1966	$3,796,000,000
1967	$8,702,000,000
1968	$25,161,000,000
1969	(surplus, $3,236,000,000)
1970	$2,845,000,000
1971	$23,033,000,000
1972	$23,373,000,000
1973	$14,849,000,000
1974	$4,688,000,000
1975	$45,188,000,000
1976	$79,390,000,000
1977	$44,963,000,000
1978	$48,839,000,000
1979	$27,280,000,000
1980 (estimate)	$60,900,000,000
1981 (estimate)	$60,000,000,000

* *

People are leaving the big cities and more particularly the cold big cities. Here is the amazing proof.

Frost-belt urban populations

City	1960	1970	1980*
Boston	697,197	641,071	562,118
Chicago	3,550,404	3,369,357	2,969,570
Cleveland	876,050	750,879	572,532
Detroit	1,670,144	1,514,063	1,192,222
Gary, Ind.	178,320	175,415	151,859
Newark, N.J.	405,220	381,930	329,498
N.Y.C.	7,781,984	7,895,563	7,015,608
Pittsburgh	604,332	520,089	423,962
St. Louis	750,026	622,236	448,640

*Preliminary figures

Source: US Census Bureau

Speaking of cities, NYC has reduced its police force by one third since 1970. Population since 1960 is down by one million. Yet in 1960 there were 390 murders in NYC. In 1980 there were 1,787 reported murders. There were 82,572 violent street crimes in NYC in 1980 or 226 a day! Here in San Diego gun shops report sales of 15 to 25 handguns a week, up 50% from three years ago. And 25% to 33% of these sales are to women! Official figures show that 11,000 handguns were sold in SD last year. Many homes now display gun club stickers or signs such as "Armed, unsafe for criminals."

* *

Want to know the real story on the B-1 bomber? Here it is, all wrapped up in three paragraphs. As for the MX missile program, forget it. There isn't enough money in the nation to get MX going, even if it was a valid program (which it isn't).

> But to Perry, the top civilian research official at the Pentagon, the technical issues are secondary. "The primary question is whether this is the appropriate time to bring this weapon system into the operational inventory," he said.
>
> To push for a new bomber, whether the stretched FB-111 or the updated B-1, in the 1985-87 period would have very serious financial and industrial consequences, he said. During this time, the peak costs of the new MX missile will hit, as well as continuing high costs for the Trident submarine and cruise missile programs.
>
> "Even if money were unlimited, other resources are not," he said. "The aerospace industry is already overtaxed due to defense and commercial orders. We already have a 2- to 2½-year order time for some parts. And in this overheated situation, inflation is running 15% to 20%, some 5% over the national level. Adding a new B-1 procurement would greatly aggravate the situation."

* *

Times Change: In the first Super Bowl game (1967) there were 15,000 empty seats.

* *

I have been reading some history of late, and I was shocked by the brutality of ancient times. For instance, Londoners would skin captured Vikings and nail those skins to the church walls. Another example: the sister of Robert Burns, the great Scotch hero, was kept in a cage by her British captors, a cage hung high on a castle wall. Another Scottish hero, Montrose, was hung by the British, and his body was then quartered and afixed to the gates of four different Scotch cities as a warning to "traitors." Horrible, I thought, ghastly. But how about this – as 1980 ended, there were 30 (thirty) separate wars being fought around the world, from Chad, North Yemen and East Timor to Afghanistan, El Salvador, the Philippines, Iran, Laos, Ireland and Southern Angola. And I wonder, is there any end to man's cruelty and insanity.

* *

Insider report: White collar embezzlers stole four times as much from US banks in 1980 as did gun-point bank robbers. The insiders receive less publicity!

* *

Gun control: Reagan (like the writer) is against it. How can I be sure? Well, first Nancy announced that she keeps a little automatic by her bedside. And then the President gave Mexico's President an unusual gift during his visit – a rifle with a telescopic attachment. I think he was telling us something!

* *

The American Economic Council is giving its third annual winter conference on April 2-5. It will all happen in Beverly Hill's plush Century Plaza Hotel. Conference speakers will include such economic stars as Henry Hazlitt, Nobel Prize winner Friedrich Hayek, James "Original Gold Bug" Dines, Franz "It's All Over" Pick, Howard "I Will Survive" Ruff, Verne "Go With Coal" Myers, R.E. "Colt .45" McMasters, Walt "Soybeans" Bressert, Ian "The Chart" McAvity, James "T-bills" Benham, Marty "Tell It Like It Is" Zweig, Robert "The Man from Dow Jones" Bleiberg, and many, many others including "Big Jim" Sinclair,

John "Gold Pyramid" Exter – and Richard "Beach Boy" Russell. All kidding aside, this should be a great conference, and it will have workshops, economic movies, panel discussions plus all the glamour and mystique of Beverly Hills. For full info call 213-550-6394 or write *American Economic Council*, 7th Floor, 9301 Wilshire Blvd., Beverly Hills, CA 90210.

In case you missed it, I offer large, hard cover (3-ring binders) albums containing every year of stock market action (daily) since 1896. The D-J Averages are pictured including Industrials, Transports, Utilities, bonds, volume plus notations of historical events. I know no better way to study the market than a week-end curled up with one of these albums. When I first started my market studies, I spent two solid years with the Averages, following them on a daily basis through every rally and decline in stock market history. By the time I was finished I could practically recite NYSE history on a week to week basis.

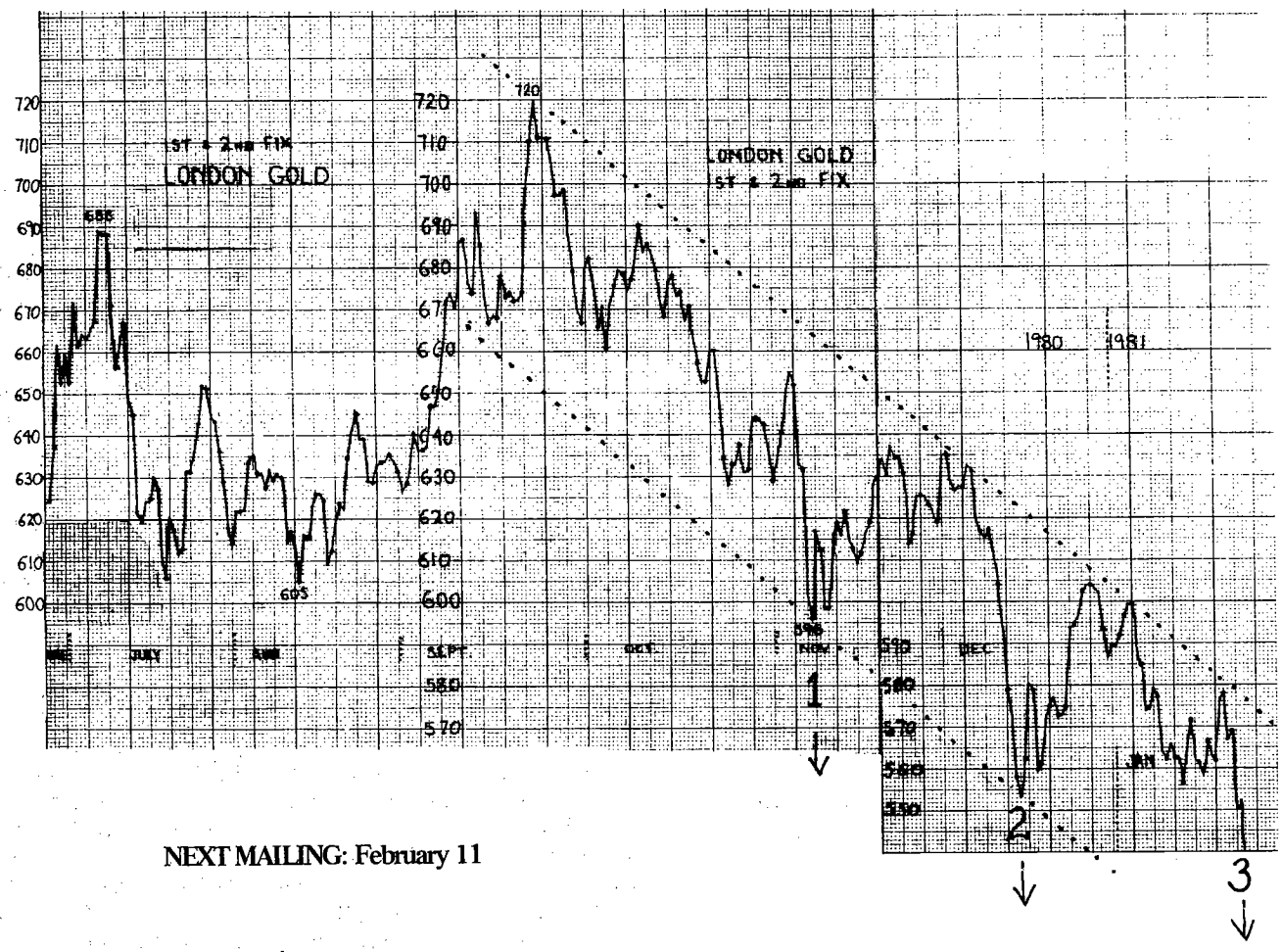
At any rate, these albums are offered at $49, or $52 to Californians. To those who already have the albums, the new 1980 pages are now ready, and the cost for the 1980 page of the Averages is $2.50 (the A-D pages for 1980 are also ready at $2.50 per page, but the A-D albums, alas, are sold out and will not be reprinted). When the albums of the D-J Averages are sold out, I will not reprint them. At that point they will be collector's items as well as invaluable study books.

GOLD: I'm going to start with this quote from friends at Warren, Cameron Co., Surrey, England: *"With the prospect of mining cost increases of up to 25% this year, the mines would have to sell gold at an average price of $680 to be able to maintain their dividends at last year's level. There is little chance of this happening, and as the Gold Mine Index has outrun the performance of gold itself in recent months, we anticipate further substantial falls (in gold shares)."* I would agree with this trenchent thought.

I have noticed on my own daily chart of the ratio of gold to gold share that bullion since December 11 has outperformed the gold shares.

Now study the gold chart on this page (this chart shows the 1st and 2nd London fix each day). Note that gold, since its 720 high of September, has been walking down a very well-defined descending channel. Gold has been moving down this channel for four consecutive months, which is a long time. Note also that there have been three separate drives or "spikes" to the downside. The first carried to 596 in November, the second carried to 553 in December, and a third drive (now in progress) has carried gold down to 530 (AM London fix) on January 26.

The effect of this four-month channel and three downward drives has been to part a lot of gold traders from their money and to turn everyone stone bearish on gold. My own guess is that there should be support around 500-525, and that at the end of the current drive gold should correct upwards. On commodities: meats, grains, metals all in bear trends as the forces of deflation (debt and high interest rates) run headlong into the forces of inflation.



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